85-1245

No. 85-

Supreme Court, U.S.
FILED
JAN 21 1986
JOSEPH F. SPANIOL, JR.
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

GAF CORPORATION,

Petitioner,

—v.—

JESSE WERNER,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

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January 21, 1986

QUESTION PRESENTED FOR REVIEW

Do the Federal Arbitration Act and this Court's decision in *Southland Corp. v. Keating*, 465 U.S. 1 (1984), erase the substantive and procedural court protections historically afforded to public corporations and their shareholders against serious breaches of fiduciary duties by senior managers, and require instead that, where a dominant executive has had an arbitration clause included in his compensation contract, such allegations of breach of fiduciary duty must be committed to binding arbitration?

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No. 85-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

GAF CORPORATION,

Petitioner,

— v. —

JESSE WERNER,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEALS OF THE STATE OF NEW YORK

GAF Corporation ("GAF") petitions this Court for a writ of certiorari to the Court of Appeals of the State of New York.[1]

[1] Pursuant to Rule 21.1(b) of this Court, the following is a listing of all parties to the litigation from which this petition arises who are not named in the caption of the petition: T. Roland Berner, Peter Bosshard, Augustine R. Marusi, Herman Sokol, Nolan B. Sommer and Robert Spitzer. These individuals, like respondent Jesse Werner, are former directors of GAF whom the corporation has sued for waste, breach of fiduciary duty and corporate unfairness. However, the decision of the New York Court of Appeals from which this petition is filed concerns only the arbitrability of disputes between respondent Jesse Werner and GAF. Only Werner purports to be entitled to assert a claim in arbitration against GAF; the remaining former directors of GAF thus did not participate in the litigation before the New York Court of Appeals.

For the foregoing reasons, GAF states pursuant to Rule 19.6 of this Court that the above-mentioned former directors of the corporation have no interest in the outcome of this petition.

OPINION BELOW

The opinion of the New York Court of Appeals, which is reported at 66 N.Y.2d 97 (1985), is reprinted in Appendix A (A- 1-9).

JURISDICTION

The decision of the Court of Appeals, dated and entered October 22, 1985, was based on the Federal Arbitration Act, 9 U.S.C. § 1, *et seq.*.

This Court has jurisdiction to grant a writ of certiorari pursuant to 28 U.S.C. § 1257(3). The order and opinion of the New York Court of Appeals are the final state court determination of a proceeding initiated by petitioner GAF in February 1984 which sought to stay the arbitration demanded by respondent Jesse Werner.[2] Moreover, the federal issue of the arbitrability of the dispute between GAF and Werner cannot be raised in any subsequent litigation between the parties. Thus, unless this Court grants the writ of certiorari now sought by GAF, the federal issue of arbitrability under the Federal Arbitration Act will have been finally determined by the order of the New York Court of Appeals. *See Cox Broadcasting Corp. v. Cohn*, 420 U.S. 469, 481-83 (1975); *accord Southland Corp. v. Keating*, 465 U.S. 1, 6-8 (1984); *American Export Lines, Inc. v. Alvez*, 446 U.S. 274, 277-78 (1980).

STATUTE INVOLVED

The statutory provision pertinent to this case, Section 2 of the Federal Arbitration Act, 9 U.S.C. § 2, is reprinted in Appendix B (A-30).

STATEMENT OF THE CASE

GAF is a publicly held company. Respondent Jesse Werner ("Werner") was both Chairman of the Board and Chief Executive Officer for some 20 years. Particularly during the last decade of Werner's tenure, his conduct of GAF's affairs was widely

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[2] The proceeding thus commenced by GAF was independent of, and has not been consolidated with, other litigation between parties. *See* A-29.

acknowledged to be a disaster. Forbes Magazine described GAF as having "one of the worst corporate performance records in American industry," and Werner was rated by other independent business analysts as one of the ten worst chief executives of comparable American companies. However, while GAF's financial condition deteriorated precipitously under this mismanagement, Werner's compensation rose dramatically. These skyrocketing compensation arrangements were incorporated into a contract containing an arbitration clause which was rubber-stamped by Werner's handpicked and improperly dominated Board of Directors. The Board consisted largely of individuals who reported to Werner at GAF or had reciprocal business dealings with GAF.

The misconduct and gross mismanagement by Werner and his Board understandably led to the institution of a number of shareholder derivative actions – five in all. Brought on GAF's behalf, these actions charged Werner and his Board of Directors with a broad range of wrongdoing, including corporate unfairness and waste in connection with his compensation, a course of corrupt self-dealing among Werner and various directors, and other breaches of fiduciary duties to the shareholders of GAF.

Although the amount of Werner's compensation was one of the matters challenged in these derivative actions, Werner, while he remained at GAF's helm, did not attempt to invoke any arbitration rights and was content to appear in the court proceedings and let the courts deal with the issue. However, Werner's mismanagement of the affairs of GAF and the Company's continuing financial decline led to his ouster in a proxy fight. *See GAF Corp. v. Heyman*, 724 F.2d 727 (2d Cir. 1983). GAF's new management then submitted the question of the disposition of the derivative actions to a special committee of the Board of Directors. When the committee reported back that the claims had substantial merit, GAF concluded it was obliged to continue to prosecute them.

As a result of this determination, GAF caused the pending shareholder derivative actions to be discontinued or stayed by representing that the Company would consolidate and continue them. In compliance with this commitment, GAF filed the suit

against Werner and other directors now pending in the New York Supreme Court. That action — as a continuation of the various shareholder derivative actions — likewise charged that Werner improperly controlled the Board by, among other means, questionable business dealings between them and GAF, and that Werner and his Board had committed various acts of corporate waste and unfairness, including but not limited to conferring grossly excessive compensation on Werner.[3]

After Werner was advised that GAF was exploring whether to continue to pursue in court the charges previously made in the shareholder derivative actions, he demanded arbitration of his rights under the employment contract which the derivative actions challenged as unlawful and excessive. GAF's petition to stay the arbitration, which was served promptly after Werner's demand for arbitration, was ultimately denied by the New York Court of Appeals, leaving Werner free to litigate the issues as to his breach of fiduciary duty in the forum of his choice.[4] *See* A- 19-29 (the initial decision of Special Term of the New York Supreme Court denying GAF's petition to stay arbitration), and A- 12-18 (the decision of the Appellate Division of the New York Supreme Court reversing the decision of the trial court and granting GAF's petition).

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[3] By the time of Werner's ouster, a compensation package worth well over $5,000,000 had been put in place for him to "persuade" him not to retire. This did not include an additional lump sum payment of $1,500,000 unlawfully extracted from GAF by Werner, just before leaving, in a manner which jeopardized the interests of Werner's co-workers in a retirement plan.

[4] The preceding statement of the factual background to GAF's present petition is based on the allegations in GAF's papers in support of its motion to stay arbitration. *See also* the Opinion of the New York Court of Appeals at A- 2-4.

REASONS FOR GRANTING THE WRIT

THE OPINION OF THE NEW YORK COURT OF APPEALS ERRONEOUSLY DECIDED AN IMPORTANT ISSUE OF FEDERAL LAW

In this case involving claims by and against the dominant executive of a publicly-held corporation, New York's highest court held that *Southland Corp. v. Keating*, 465 U.S. 1 (1984) ("*Southland*") and the Federal Arbitration Act ("FAA") compelled arbitration even though an arbitration award could collaterally estop GAF and its shareholders from presenting in court their claims of corporate unfairness and waste.[5]

This case thus raises a federal question of great significance to public corporations and their shareholders: whether this Court's decision in *Southland* so extends the preemptive effect of the FAA as to compel an arbitration which could erase the substantive and procedural court protections historically afforded to public corporations and their shareholders against breach of fiduciary duty and waste by management.

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[5] *See infra* at 11-12 on the potential collateral estoppel effects of an award in arbitration.

A. The Decision Of The Court Of Appeals Will Result In Substantial Injury To Shareholders Of Publicly Held Companies

The validity of Werner's September 1981 employment agreement under which he now seeks arbitration had been challenged in five shareholder derivative actions brought long before Werner's ouster. Those actions, which have been continued and consolidated by GAF, allege that the agreement, which was not approved by GAF's shareholders, is entirely void because it represents an act of corporate unfairness and waste, and because the Board which approved it was so dominated by Werner that the Board was legally incapable of giving GAF's approval. Preventing GAF and its shareholders from pursuing those claims against Werner in court will deprive them of important substantive and procedural protections. As this Court stated in *Alexander v. Gardner-Denver Co.*, 415 U.S. 36, 53, 57-58 (1974):

> The arbitrator . . . has no general authority to invoke public laws that conflict with the bargain between the parties . . .
>
> * * *
>
> . . . the factfinding process in arbitration usually is not equivalent to judicial factfinding. The record of the arbitration proceedings is not as complete; the usual rules of evidence do not apply; and rights and procedures common to civil trials, such as discovery, compulsory process, cross-examination, and testimony under oath, are often severely limited or unavailable. *See Bernhardt v. Polygraphic Co.*, 350 US 198, 203 (1956); *Wilko v. Swan*, 346 US, at 435-437. And as this Court has recognized, "[a]rbitrators have no obligation to the court to give their reasons for an award." *United Steelworkers of America v. Enterprise Wheel & Car Corp.*, 363 US [593, 598 (1960)].

Since an arbitrator is not bound by substantive rules of law, public shareholders could lose the protections historically afforded them

under judicial decisions which define the responsibility of corporate executives for waste, mismanagement and fraud.

As this Court has recognized, an essential purpose of the shareholder derivative action is to protect shareholders against just the sort of misconduct by dominant corporate insiders which GAF and its shareholders have alleged in this case.[6] The interpretation placed by the court below on *Southland* and the FAA threatens this essential function of the shareholder derivative action. The court below held:

> Under the Federal Arbitration Act it is not a basis for stay of arbitration that the arbitrator may be called upon to consider issues of waste and overreaching on the part of a corporate officer that are also involved in an action under Business Corporation Law § 720 [which governs actions in the name of a corporation against its officers or directors] brought by the corporation against the officer, or that a party to the court proceeding may later argue that the arbitrator's determination should be given preclusive effect.

(A-2). This interpretation, if allowed to stand, will mean that corrupt or incompetent corporate managements, by including arbitration clauses in wasteful executive employment contracts and other improper agreements, will be free to select in advance the forum and rules under which these same managements will defend themselves against charges of corporate unfairness and waste made by corporate shareholders.

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[6] *Koster v. American Lumbermens Mutual Casualty Co.*, 330 U.S. 518, 522 (1947):

> The stockholder's derivative action . . . is an invention of equity to supply the want of an adequate remedy at law to redress breaches of fiduciary duty by corporate managers. Usually the wrongdoing officers also possess the control which enables them to suppress any effort by the corporate entity to remedy such wrongs. Equity therefore traditionally entertains the derivative or secondary action by which a single stockholder may sue in the corporation's right. . . .

B. The Decision Below Misinterprets The Federal Arbitration Act And This Court's Opinion In *Southland Corp. v. Keating*

The Court of Appeals' holding is based on an erroneous interpretation of federal law. Section 2 of the FAA, which provides that an agreement to arbitrate may be deemed invalid "upon such grounds as exist at law or in equity for the revocation of any contract," provides ample authority to stay arbitration in this case. 9 U.S.C. § 2. Considerations of public policy have long been recognized as "grounds. . . at law or in equity for the revocation" of contracts.[7] Moreover, arbitration should be stayed under Section 2 because corporate management lacks the authority to enter into a contract which purports to deprive shareholders of the rights ultimately at issue in this case — namely, the right to invoke the courts' protections against breach of fiduciary duty and waste by corporate executives.[8]

The Court of Appeals held that it was compelled by *Southland* to grant Werner's demand for arbitration. *E.g.*, A-6. Under the Court of Appeals' reading of *Southland*, a stay of arbitration cannot be granted under the FAA unless a federal *statutory* policy has been enunciated which is stronger than that favoring arbitration.[9] In so interpreting *Southland*, the court below not only misread this Court's opinion in that case, but also failed to acknowledge any role for federal common law in the definition of what is non-arbitrable.

In *Southland*, this Court struck down a California statute which purported to make non-arbitrable contract claims subject to the California Franchise Investment Law. The Court held that the statute was not a ground that "exists at law or in equity

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[7] *E.g.*, *Hall v. Coppell*, 74 U.S. (7 Wall.) 542 (1869); *Bank of the United States v. Owens*, 27 U.S. (2 Pet.) 527 (1829).

[8] *See infra* at 11.

[9] In its brief before the Court of Appeals, GAF argued that this Court, in a similar context involving federal common law, has enunciated a policy of relying on state corporation law. *See infra* at 9-11.

for the revocation of any contract" within the meaning of Section 2 of the FAA. Thus, this Court declined to allow the legislature of one state to revoke the provisions of the FAA to the extent applicable to a particular type of commercial contract subject to the law of that state. Contrary to the Court of Appeals' suggestion, however, *Southland* does *not* go so far as to hold that the effect of an arbitration clause on the administration of state law and nonstatutory federal law and policy is necessarily irrelevant to the issue of arbitrability under the FAA.

Southland must be viewed in the context of this Court's prior decisions under the FAA which have acknowledged the development thereunder of a federal common law as to its meaning and application. In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24, 25 n.32 (1983), this Court held that the FAA "creates a body of federal substantive law, establishing and regulating the duty to honor an agreement to arbitrate," and that "[f]ederal law in the terms of the [Federal] Arbitration Act governs that issue in either state or federal court." Thus, the judiciary must interpret as a matter of federal common law the provision in section 2 which provides for challenging an agreement to arbitrate based on "such grounds as exist at law or in equity for the revocation of any contract." *See generally United States v. Standard Oil Co.*, 332 U.S. 301 (1947); *Clearfield Trust Co. v. United States*, 318 U.S. 363 (1943).[10]

Contrary to the conclusion of the court below, nothing in the wording of Section 2 restricts the application of that provision to "grounds . . . at law or in equity" which are derived from or recognized in another federal statute. Nor does the fact that arbitrability must ultimately be determined as a matter of federal law mean that Congress intended that the FAA be used as a device to displace state corporation law.

The public policy at issue here is one which has been recognized by this Court and by every state in the country: the need to assure

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[10] In other areas governed by federal common law, the courts have developed applicable law on a case-by-case basis as required to ensure the appropriate regulation of such areas. *E.g.*, *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 726-28 (1979).

shareholders of the right to pursue in court claims of breach of fiduciary duty, corporate unfairness and waste on the part of corporate management. This Court has clearly stated that the preservation of state corporation law is an important *federal* policy. In *Burks v. Lasker*, 441 U.S. 471, 477-78 (1979), a case involving a shareholder derivative action against directors of an investment company registered under federal law, this Court held as follows:

> The fact that "the scope of [respondents'] federal right is, of course, a federal question" does not, however, make state law irrelevant. *De Sylva v. Ballentine*, 351 U.S. 570, 580 (1956). Cf. *United States v. Kimbell Foods, Inc.* [440 U.S. 715 (1979)] at 727-728. It is true that in certain areas we have held that federal statutes authorize the federal courts to fashion a complete body of federal law. *See Textile Workers v. Lincoln Mills*, 353 U.S. 448, 451, 456-457 (1957). Corporation law, however, is not such an area.
>
> A derivative suit is brought by shareholders to enforce a claim on behalf of the corporation. [citation omitted] This case involves the question whether directors are authorized to determine that certain claims not be pursued on the corporation's behalf. As we have said in the past, the first place one must look to determine the powers of corporate directors is in the relevant State's corporation law. *See Santa Fe Industries, Inc. v. Green*, 430 U.S. 462, 479 (1977); *Cort v. Ash*, 442 U.S. 66, 84 (1975)."Corporations are creatures of state law," *ibid.*, and it is state law which is the font of corporate directors' powers. * * * In short, in this field congressional legislation is generally enacted against the background of existing state law; Congress has never indicated that the entire corpus of state corporation law is to be replaced simply because a plaintiff's cause of action is based upon federal statute. *Cort v. Ash*, *supra*; *Santa Fe Industries Inc. v. Green*, *supra*.

To negate the state substantive law governing breach of fiduciary duty, corporate unfairness and waste by compelling arbitration

of such claims against former corporate officers and directors would directly undermine the federal policy of preserving – and relying upon – state corporation law.[11]

Moreover, this Court's opinion in *Southland* strongly supports the contention that if a party lacks the authority to enter into an arbitration agreement applicable to a particular type of dispute, arbitration may be stayed under Section 2 of the FAA. 465 U.S. at 16 n.11 ("general contract defenses" cognizable under Section 2 of the FAA). Here, GAF's management lacked the contractual capacity to enter into an agreement which purports to foreclose the corporation and its shareholders from proving in court their claims of mismanagement and breach of fiduciary duty. The authority of corporate management to settle or dismiss claims of waste and breach of fiduciary duty is recognized to be limited by the supervening rights of shareholders. *See, e.g., Zapata Corp. v. Maldonado*, 430 A.2d 779 (Sup. Ct. Del. 1981) (holding that corporate management does not have unfettered and unreviewable authority to dismiss shareholder derivative actions). If corporate executives do not have absolute authority to dismiss or settle a pending dispute concerning corporate mismanagement, they cannot enter into a pre-dispute arbitration clause which, if enforced, would have the same effect of depriving shareholders of their access to the courts.

Nor is it any answer to say that GAF, following an award in the arbitration, could still present in court its case that Werner's compensation constitutes corporate unfairness and waste. If arbitration is compelled, GAF will be forced either to submit to the arbitrator its defenses of corporate unfairness and waste in proceedings not subject to effective judicial review, or to take the

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[11] *Burks v. Lasker* is also relevant here because it holds that under another federal statute, the Investment Company Act, courts must refer to the law of the state of incorporation to determine whether corporate management has authority to dismiss a shareholder derivative action alleging misfeasance by management. As noted *infra* on this page, the law of the State of Delaware, in which GAF is incorporated, is that management does not have unlimited authority to make such a binding determination. Similarly, management lacks the authority to require GAF's shareholders to present their claims in a forum, and under rules, selected by management.

risk of never being able to present its case in any forum. In either event, GAF would necessarily run the very substantial risk of being collaterally estopped from presenting its case in the pending litigation in court. Moreover, this is not a situation where one party has advanced both arbitrable and non-arbitrable claims, all of which can be litigated fully and freely in each respective forum. Rather, GAF in the arbitration has a non-arbitrable *defense* to Werner's claims, *i.e.*, the defense that the very agreement under which Werner seeks additional compensation through arbitration is void for waste, self-dealing and breach of fiduciary duty. Thus, this controversy cannot practically be divided between the plaintiff's case and the defendant's case; it must be decided in its entirety in court in order to preserve the non-arbitrable integrity of GAF's defenses and claims of corporate unfairness and waste.[12]

In sum, the New York Court of Appeals' erroneous interpretation of the FAA and *Southland* will necessarily impair significantly the interests of the shareholders of public corporations and their shareholders. Although the very purpose of an action against corporate officers or directors, whether brought on behalf of the corporation by a derivative action or directly, is to protect shareholders against abuses by corporate management, the decision, if left to stand, will effectively deprive public shareholders, who have never consented to arbitration, of protections historically afforded them by the courts. This case thus raises "an important question of federal law which has not been, but should be, settled by this Court." Rule 17.1(c) of the Rules of this Court.

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[12] *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. ____, 105 S.Ct. 1238 (1985) ("*Dean Witter*"), does not hold otherwise; indeed, it is readily distinguishable. There this Court held that where "arbitrable and nonarbitrable claims arise out of the same transaction," arbitration on the arbitrable claim should not be stayed on grounds of the overlap or intertwining with the non-arbitrable claim. 105 S.Ct. at 1240. In such a situation involving overlapping *claims*, a postarbitration judicial proceeding would focus on whether a plaintiff should be allowed a second opportunity to litigate where an arbitrator had already decided a related claim. In the case at bar, by contrast, a post-arbitration judicial proceeding would likely focus on whether to overturn the arbitration award on the grounds that an argument essential to the full and fair *defense* of the arbitration – here, GAF's claim that Werner's employment agreement was void on grounds of corporate unfairness and waste – had not been presented to, or could not properly be decided by, the arbitrators. Such a judicial proceeding would manifestly constitute a collateral attack on any award made in arbitration, a result hardly consistent with the tenor of this Court's opinion in *Dean Witter*.

CONCLUSION

Certiorari should be granted.

Dated: New York, New York
January 21, 1986

Respectfully submitted,

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APPENDIX

APPENDIX A

STATE OF NEW YORK
COURT OF APPEALS

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1 No. 423

GAF Corporation,

Respondent,

v.

Jesse Werner,

Appellant, OPINION

et al.,

Defendants.

(Action No. 1)

In the Matter of GAF Corporation,

Respondent,

v.

Jesse Werner,

Appellant.

(Proceeding No. 2)

---

and another action:
Werner v. GAF

(Action No. 3)

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MEYER, J.

Under the Federal Arbitration Act it is not a basis for stay of arbitration that the arbitrator may be called upon to consider issues of waste and overreaching on the part of a corporate officer that are also involved in an action under Business Corporation Law § 720 brought by the corporation against the officer, or that a party to the court proceeding may later argue that the arbitrator's determination should be given preclusive effect. The order of the Appellate Division should, therefore, be reversed, with costs, and the order of Special Term, New York County, should be reinstated.

GAF Corporation is a Delaware corporation engaged in the manufacture and sale of chemicals and other products. Jesse Werner joined the company in 1938 as a research chemist and remained with it until December 1983, when, after losing a proxy fight, he was terminated. He was then chairman of the board of directors, a position he had held since 1964. At the time he was terminated he was serving under a written agreement dated September 17, 1981, under which he was employed by GAF for a term of five years at a salary of $425,000 for the first year, increasing each year thereafter by $25,000, plus lifetime dental, medical and hospital benefits for himself and his wife and supplemental retirement benefits. He had also been granted options to purchase 120,000 shares of common stock under a stock option plan adopted by GAF in 1975.

As a result of Werner's termination he was not paid the salary due him for the last half of December 1983 or the first half of January 1984 and on January 9, 1984 was advised that pending the report of a study committee investigating his relationship with the company neither salary nor benefits would be paid. On January 18, 1984, Werner demanded arbitration pursuant to paragraph 12 of his employment agreement.* GAF then moved

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* That paragraph provides in pertinent part: "In the event that any disagreement of any kind shall arise between the parties hereto as to any matter or thing whatsoever hereunder,such disagreement shall be arbitrated in the City of New York". The stock option agreements contained no arbitration provision.

to stay arbitration, and Werner cross-moved to compel arbitration and to disqualify GAF's designated arbitrator.

On January 3, 1984, Werner advised GAF of his intention to exercise his options to purchase 120,000 shares of its stock. He thereafter tendered payment by certified check of the $1,323,500 consideration due for those shares, but delivery was refused. On February 13, 1984, Werner began an action against the corporation for compensatory and punitive damages for breach of the stock option agreements and against the new board of directors for compensatory and punitive damages for emotional distress.

In 1982 and 1983, during Werner's tenure as chairman of the board, five separate derivative actions were begun in the Delaware Chancery Court, in New York State Supreme Court and in the United States District Court for the Southern District of New York against the corporation, Werner and the other members of the board of directors. Those actions charged mismanagement, waste, unfairness and self-dealing, resulting in approval by the board of Werner's salary and benefits and improper and excessive use of corporate funds in the proxy battle. After its study committee's report, the new board determined that the derivative claims against the old board should be prosecuted by the corporation. On March 5, 1984, such an action by the corporation was begun and was followed by an application to stay Werner's stock option action or, in the alternative, to consolidate it with GAF's action.

Special Term denied GAF's motion to stay arbitration, granted Werner's motion to compel arbitration but denied his motion to disqualify GAF's arbitrator, and granted GAF's consolidation request but stayed trial of so much of the consolidated action as related to Werner's compensation rights under the September 17, 1981 employment agreement until completion of the arbitration. In denying the stay of arbitration, the Special Term Judge reasoned that GAF was involved in interstate commerce and, therefore, the Federal Arbitration Act (9 USC §1-14) applied, that under both federal and state law the validity of the agreement to arbitrate was a matter for the arbitrator and that the claims which

involved overriding public policy considerations were minimal and did not so permeate the arbitrable issues as to require a stay.

The Appellate Division disagreed. Notwithstanding that CPLR 7503, dealing with stay of arbitration, contained no provision for a stay under such circumstances, it found authority to do so in CPLR 2201, which permits a stay to avoid a multiplicity of suits, and in the inherent power of the courts to control matters on its docket. It concluded that a stay of arbitration was required in the interests of justice because the arbitrable issue was but a minor part of the larger controversy presented by the GAF action, because the arbitrators may reach results inconsistent with the courts and because the members of the old board other than Werner who are defendants in GAF's action are not parties to the arbitration, but may be affected collaterally by the arbitrator's determination. It, therefore, modified Special Term's order by granting the stay of arbitration, denying the cross-motion to compel arbitration, and vacating the stay of trial. Werner appeals to us as of right (CPLR 5601[a]). We conclude that under the federal law applicable to this case, arbitration should not have been stayed and, therefore, reverse.

II

The Federal Arbitration Act (Act) provides that arbitration agreements "shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract" (9 USC §2). In a series of recent decisions the United States Supreme Court has emphasized again and again the overriding force of the policy favoring arbitration thus declared.

Those cases make clear that the Act is "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary" (*Cone Hosp. v Mercury Constr. Corp.*, 460 US 1, 24) and that, subject to only two limitations, it withdrew from the states the power to require resolution in a judicial forum of a claim which the parties have agreed to arbitrate, those limitations being that the arbitration agreement "must be part of a written maritime contract or a contract 'evidencing a transaction involving commerce' and such

claims may be revoked upon 'grounds as exist at law or in equity for the revocation of any contract' " (*Southland Corp. v Keating*, 465 US 1, ____, 104 S Ct 852, 858). The right which the Act grants to enforce an arbitration provision is not dependent upon the forum — federal or state — in which it is asserted (*id.*, 465 US, at p ____, 104 S Ct, at pp 860-861), nor will fraud in the inducement of the contract in which is contained the arbitration clause defeat the right (*id.*, 465 US, at p ____, 104 S Ct, at p 858; *Cone Hosp. v Mercury Constr. Corp.*, 460 US, at p 24 *supra*; *Prima Paint Corp. v Flood & Conklin Corp.*, 388 US 395; *see*, Ann., 11 ALR4th 774).* The preeminent concern of the Congress being that arbitration agreements within the coverage of the Act be carried out, such agreements are to be rigorously enforced, absent a countervailing policy in another federal statute, even if the result is "piecemeal" litigation of the issues in separate proceedings in different forums (*Dean Witter Reynolds v Byrd*, 470 US ____, ____, 105 S Ct 1238, 1241-1243; *Cone Hosp. v Mercury Constr. Corp.*, 460 US, at p 20, *supra*). Nor is the potentially preclusive effect of the arbitrator's determination in the Judicial forum a reason for refusing to compel arbitration, although the Judge must consider in deciding whether and to what extent to accord preclusive effect to the arbitrators' holding not only the differences in the expertise and authority of, and fact-finding procedures used by, the arbitrators from those of the judge, but also

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* *Prima Paint* held (388 US, at pp 403-404) that in view of the direction in section 4 of the Act that the court consider "the making of the agreement for arbitration," a court could determine whether the arbitration *clause* itself had been induced by fraud, but not whether the *contract* in which it was contained was so induced, that being an issue for the arbitrator, and both the *Southland* and *Cone* cases were careful to preserve that distinction. GAF's brief seeks to bring this case within the distinction by arguing that Werner's arbitration *clause* was a product of overreaching, but its petition claimed only that the *agreement* was void for waste and self-dealing and its papers contain nothing relating to the invalidity of the *clause* as distinct from the *agreement*. The issue, not having been considered by the courts below, is not properly before us. Therefore, we do not consider it further (*Matter of Lane [Abel-Bey]*, 50 NY2d 864). Likewise not considered because not raised below is GAF's contention that by failing to raise the arbitration clause in the earlier derivative actions, Werner has waived the right to arbitration.

any difference in the interest of the party pressing the arbitration claim from that of the party litigating before the judge, and the federal and state statutory interests to be protected (*Dean Witter Reynolds v Byrd*, 470 US, at p ____, 105 S Ct, at pp 1243-1244, *supra*; *McDonald v City of W. Branch*, 446 U.S. 284, ____, 104 S Ct 1799, 1802-1804).

Applying these principles in the *Southland* case, the Supreme Court held the policy of the California Franchise Investment Law, which the California Supreme Court had interpreted to mandate judicial, and exclude arbitral, consideration, to be in violation of the Act and of the Supremacy Clause of the federal Constitution (art VI, cl 2). The statutory policy embodied in Business Corporation Law § 720, which, GAF argues, was intended to protect shareholders of a publicly held corporation against the waste, overreaching and misconduct of corporate officers and directors, against which such shareholders are ill equipped to protect themselves, differs little, if at all, from that of the California statute. Neither the public shareholder nor the franchisee has much bargaining power, but both the franchisor and the directors and officers of a publicly held corporation are subject to governmental oversight. We conclude, therefore, with respect to Business Corporation Law § 720, that the Supreme Court decisions, and particularly the *Southland* decision, foreclose according it the effect for which GAF contends.

GAF argues also that a stronger federal statutory policy than that which favors arbitration may proscribe enforcement of an arbitration clause and points to the Securities Act of 1933 (15 USC §77a ff) and the Sherman Antitrust Act (15 USC §1 ff) as examples of statutes that have been given that effect. The Supreme Court has held in *Wilko v Swan* (346 US 427) that a pre-dispute agreement to arbitrate claims under the Securities Act of 1933 is not enforceable, but in *Scherk v Alberto-Culver Co.* (417 US 506) and again in *Dean Witter Reynolds v Byrd* (470 US, at p ____, n 1, 105 S Ct, at p 1240, n 1) reserved the question whether the Securities Exchange Act of 1934 (15 USC §78a ff) has the same effect. Neither the complaint in the GAF action nor its brief in this Court refers to any particular section of either securities law

as applicable and we do not deem it necessary to parse these statutes in light of the fact that only the employment agreement contains an arbitration provision and only the issues relating to Werner's compensation rights were stayed by Special Term's order. Thus, GAF remains free to litigate any issues which might be affected by either securities law raised by the stock option contracts on which Werner sued, or the excessive proxy fight expenditures involved in GAF's second cause of action. It is at risk, therefore, if the arbitration proceeds, only to the extent that it raises such issues before the arbitrators as a defense to the compensation claim, but, as we have already seen, is free to argue the overriding federal policies of the securities laws as a reason why any determination of the arbitrators adverse to it on those issues should not be given preclusive effect. Nor, in view of the holding in *Dean Witter Reynolds*, 470 US, at p ____, 105 S Ct, at pp 1240-1241, *supra*), can its suggestion that the issues are inextricably intertwined avail it.

We conclude, therefore, that the issues in the consolidated action do not so involve a federal policy preemptive of the policy favoring arbitration enunciated by the Federal Arbitration Act as to require that arbitration be stayed,* and that, in any event, Business Corporation Law § 720 could not constitutionally be given that effect.

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* GAF points to the method for selection of the arbitrators outlined in the arbitration clause of the employment agreement (each party to appoint an arbitrator, the third "neutral arbitrator" to be selected by the two thus chosen or if they cannot agree by the President of the Association of the Bar of the City of New York) as an added policy reason against enforcement "[s]ince an arbitrator * * * would be selected pursuant to a procedure established by the very defendants he is to judge." To Special Term's response that this method of choosing arbitrators has long been approved as a matter of New York law (*Matter of Astoria Med. Group [Health Ins. Plan]*, 11 NY2d 128) we add that section 5 of the Federal Arbitration Act directs that if the contract for arbitration contains provision for a method of appointing arbitrators "such method shall be followed" (9 USC §5).

III

The ambiguity arising from the fact that sections 3 and 4 of the Federal Arbitration Act speak only of United States courts has been noted by the Supreme Court in *Cone Hosp. v Mercury Constr. Corp.* (460 US, at p 26, nn 34, 35, *supra*) and is pointed up by the fact that the consolidated action and the stay proceeding are in state, rather than federal, court. There is no question that state courts are obligated by section 3 to grant a stay of arbitration (*id.*), but, as the *Cone* opinion states, it is less clear whether the same is true of an order to compel arbitration under section 4 of the Act (*id.*). Although GAF has not argued that so much of the Special Term order as compels it to arbitrate is improper (presumably because that would simply precipitate a federal court application for such an order [*id.*, at p 27]), we deem it proper to note the basis of our approval of that portion of the order.

Although the Arbitration Act does not contain a provision similar to that in the federal Civil Rights Act directing that to the extent that the federal laws "are deficient in the provisions necessary to furnish suitable remedies * * * the common law, as modified and changed by the constitution and statutes of the State wherein the court having jurisdiction of such * * * cause * * * shall * * * govern the said courts in the trial and disposition of the cause" (42 USC §1988), we conclude that the necessary effect of requiring that state courts enforce the Arbitration Act is the same, at least where, as in New York, there exists a statutory procedure for compelling arbitration (CPLR 7503[a]). This is not a situation such as was involved in *Matter of Rederi (Dow Chem. Co.)* (25 NY2d 576, *cert denied* 398 US 939) where application of New York procedural law would be outcome determinative. To the contrary, as the *Cone* opinion notes, refusing to do so would achieve no more than to require an application to a federal court, "a pointless and wasteful burden on the supposedly summary and speedy procedures prescribed by the Arbitration Act" (460 US, at p 27), and "at least one state court has held that §4 does require state courts to issue §4 orders to arbitrate where the section's conditions are met. *Main v Merrill Lynch, Pierce, Fenner*

& Smith, Inc., 67 Cal. App. 3d 19, 24-25, 136 Cal. Rptr. 378, 380-381" (460 US, at p 26, n 35).*

Moreover, doing so is consistent with our cases construing a broad arbitration clause, such as is in Werner's employment contract, in conjunction with the mandate of CPLR article 75, to require submission to arbitration of all issues, including fraud in the inducement of the contract, except such as are specifically excluded by enumeration in the arbitration clause itself (*Matter of Silverman [Benmor Coats]*, 61 NY2d 299, 308; *Bayly, Martin & Fay v Glaser*, 60 NY2d 577, *affg* 92 AD2d 850; *Matter of Nationwide Gen. Ins. Co. v Investors Ins. Co.*, 37 NY2d 91; *Matter of Weinrott [Carp]*, 32 NY2d 190).

For the foregoing reasons, the order of the Appellate Division is reversed, with costs, and the order of Special Term is reinstated.

Chief Judge WACHTLER and Judges JASEN, SIMONS, KAYE and TITONE concur; Judge ALEXANDER taking no part.

Order reversed, etc.

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* Indeed, a number of state courts other than California have enforced an arbitration clause governed by the federal Act (*Merrill Lynch, Pierce, Fenner & Smith v Melamed*, 453 So 2d 858 [Fla]; *Merrill Lynch, Pierce, Fenner & Smith v Falowski*, 425 So 2d 129, 130 [Fla]; *Pittsfield Weaving Co. v Grove Textile*, 121 NH 344, 430 A2d 638; *Episcopal Hous. Corp. v Federal Ins. Co.*, 269 SC 631, 239 SE2d 647; *Merrill Lynch, Pierce, Fenner & Smith v McCollum*, 666 SW2d 604 [Tex], *writ refd n.r.e., cert denied ___ US ___, 105 S Ct 811, reh denied ___ US ___, 105 S Ct 1384*; *Allison v Medicab Intl.*, 92 Wn 2d 199, 597 P2d 380; *see, Palmer Constr. Co. v Wichita Band Instrument Co.*, 7 Kan App 2d 363, 642 P2d 127; *Village of Cairo v Bodine Contr. Co.*, 685 SW2d 253 [Mo]; *Sentry Sys v Guy*, 98 Nev 507, 654 P2d 1008; *Dean Witter Reynolds v Roven*, 94 NM 273, 609 P2d 720; *Burke County Public Schools v Shaver Partnership*, 303 NC 408, 279 SE2d 816; *Tennessee Riv. Pulp & Paper Co. v Eichleay Corp.*, 637 SW2d 853 [Tenn]).

Remittitur

COURT OF APPEALS
STATE OF NEW YORK

The Hon. Sol Wachtler, Chief Judge, Presiding

1 No. 423

GAF Corporation,

Respondent,

v.

Jesse Werner,

Appellant,

et al.

Defendants.

(Action No. 1)

In the Matter of GAF Corporation,

Respondent,

v.

Jesse Werner,

Appellant.

(Proceeding No. 2)

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and another action:
Werner v. GAF

(Action No. 3)

The appellant(s) in the above entitled appeal appeared by Richenthal, Abrams & Moss, Eqs.;
the respondent(s) appeared by Holtzmann, Wise & Shepard, Esqs.

The Court, after due deliberation, orders and adjudges that the order is reversed, with costs, and order of Supreme Court,

New York County, reinstated. Opinion by Judge Meyer. Chief Judge Wachtler and Judges Jasen, Simons, Kaye and Titone concur. Judge Alexander took no part.

The Court futher orders that the papers required to be filed and this record of the proceedings in this Court be remitted to the Supreme Court, New York County,

there to be proceeded upon according to law.

I certify that the preceding contains a correct record of the proceedings in this appeal in the Court of Appeals and that the papers required to be filed are attached.

_____

Donald M. Sheraw, Clerk of the Court

Court of Appeals, Clerk's Office, Albany, October 22, 1985

GAF CORP v. WERNER [106 AD2d 41]

GAF Corporation, Appellant, v. Jesse Werner, Respondent, et al. Defendants. (Action No. 1)

In the Matter of the Arbitration between GAF Corporation, Appellant, and Jesse Werner, Respondent. (Proceeding No. 2)

Jesse Werner, Respondent, v. GAF Corporation, Appellant, et al. Defendants. (Action No. 3.)

First Department, January 22, 1985

OPINION OF THE COURT

Ross, J.

GAF Corporation (GAF) manufactures and sells chemicals, photographic products, and building materials. It is a Delaware corporation and its principal place of business is located in New York County. In 1965, GAF became a publicly held company and its common and preferred stock are listed and traded on the New York Stock Exchange. This corporation had approximately 45,000 shareholders in 1983.*

Jesse Werner (Werner) has spent his entire career with GAF, commencing in 1938 as a research chemist. Over the next 26 years Werner rose through the corporate ranks, and in 1964 he was elected chairman of the board of directors. Thereafter, he held that post until December, 1983, when he was terminated by new management, which had won a proxy fight.

In the two years preceding the firing of Werner, five separate shareholder derivative actions had been filed against Werner and the members of the board of directors (the old Board) that were serving with him. The common thread that ran through these derivative actions was that Werner and the old Board were allegedly guilty of acts of financial mismanagement, corporate

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* *GAF Corp. v Heyman*, 724 F2d 727, 728 (CA2d).

unfairness, waste and self-dealing. In particular, those actions charged: (1) that Werner, while chairman, improperly controlled the old Board by his influence over the salaries, emoluments and other benefits that these persons received from GAF; (2) that allegedly this improper control led the old Board to approve, in 1981, a compensation package for Werner, which has an alleged value of about $5,000,000; (3) that allegedly this old Board improperly approved the excessive expenditure of GAF funds in waging a proxy battle, solely to protect Werner's and their position at GAF, and Werner's compensation package; and (4) that allegedly both the approval of the Werner compensation package and the funds to finance this proxy fight constituted breaches of fiduciary duty to the shareholders by Werner and the old Board members.

The subject compensation package consists of two parts. First, there is a written employment agreement between GAF and Werner, dated September 17, 1981, and it provides, in pertinent part: (a) that its term is five years; (b) that his base salary is fixed at $425,000 for the first year and each year thereafter it increases by $25,000; (c) that lifetime dental, medical and hospital benefits are provided to Werner and his wife; and (d) that he is provided supplemental retirement benefits. Second, during the period 1977 through 1981, Werner was granted stock options, to purchase 120,000 shares of GAF common stock, pursuant to GAF's 1975 stock option plan.

Following the ouster of Werner and the old Board, the successor board of directors (the new Board) appointed a special committee, chaired by former United States Senator Joseph Tydings (Tydings), to examine into, *inter alia*, the merits of the charges set forth in the five derivative suits,* mentioned *supra*, and make

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* The titles of the derivative actions are: *Stotland v GAF Corp.* (Delaware Chancery Ct, New Castle County, Civ Action No. 6876); *Miller v GAF Corp.* (Delaware Chancery Ct, New Castle County, Civ Action No. 6795); *Weinberger v Werner* (Supreme Ct, NY county, Index No. 10403/83); *Heyman v GAF Corp.* (US Dist Ct, SDNY) (Civ Action No. 82-7442); and *Heyman v GAF Corp.* (US Dist Ct, SDNY) (Civ Action No. 83-2106).

recommendations. Upon the basis of its investigation, this committee reported to the new Board that these suits contained merit, and recommended that it would be in the best interest of GAF to cause these individual actions to be discontinued, and to prosecute in the corporate name, allegations of financial mismanagement, corporate waste, self-dealing and breach of fiduciary duty against Werner and the old Board, which allegations related to the old Board's approval of Werner's compensation package and the financing of the proxy struggle. The new Board adopted this recommendation and commenced action.

The instant complaint in this GAF action (hereinafter referred to as the consolidated action) deals in the first cause of action with the alleged improprieties of Werner's compensation package, including that portion of the package that relates to the employment agreement, and deals in the second cause of action with the alleged improprieties in making available excessive funds to fight the proxy battle. GAF seeks to recover in this action compensatory and punitive damages from Werner and the old Board for their misconduct.

On or about December 13, 1983, before the new Board instituted GAF's instant action, they stopped paying Werner his salary and benefits under the 1981 employment agreement, mentioned *supra*. In response to the new Board ceasing to pay him a salary and benefits, Werner, by registered letter, dated January 18, 1984, notified the new Board of GAF that they were allegedly in breach of the employment agreement, and that he demanded arbitration of this dispute, pursuant to paragraph 12 of that agreement. Paragraph 12 reads, in pertinent part: "In the event that *any* disagreement of *any* kind shall arise between the parties hereto as to any matter or thing whatsoever hereunder, such disagreement shall be arbitrated in the City of New York" (emphasis added).

In timely fashion, GAF moved to stay arbitration, upon the basis that the dispute about the employment agreement was only a small part of the controversy between the parties, which controversy is fully set forth in the consolidated action, and that the

disposition of all of the issues in one court proceeding outweighs the public policy in favor of arbitration.

Also, prior to GAF commencing its consolidated action, Werner began his own court action against GAF to recover compensatory and punitive damages, in view of the fact that the new Board of GAF had refused to honor Werner's exercise of the stock option portion of the compensation package.

Now, after Werner's demand for arbitration and the institution of his action, GAF launched its consolidated court action. The two actions and the arbitration proceeding were all begun within two months of one another. These three matters are identified in the caption of this lawsuit in the following manner: action No. 1 is GAF's consolidated court action, proceeding No. 2 is GAF's application to stay arbitration, and action No. 3 is Werner's court action concerning the stock option.

Werner responded to GAF's petition to stay arbitration by cross-moving to, *inter alia*, compel arbitration. Furthermore, GAF cross-moved to, *inter alia*, consolidate for trial GAF's action with Werner's action.

Special term, *inter alia*, (1) denied GAF's motion to stay arbitration; (2) granted Werner's cross motion to compel arbitration; (3) granted GAF's cross motion to consolidate the two actions; and, (4) *sua sponte* stayed the trial of the consolidated actions, only insofar as the issues that relate to the employment agreement which the arbitration proceeding is to consider. We disagree.

Even though GAF moved to stay arbitration under New York law (CPLR 7503, subd [b]), the instant arbitration is governed by the Federal Arbitration Act (US Code, tit 9, §§ 1, 2 *et seq.*) since the employment agreement affects interstate commerce. As mentioned *supra*, GAF is a Delaware corporation with a principal office in New York County, it has thousands of shareholders who live in various parts of the United States, and its business operations are carried on in interstate commerce. The Supreme

Court of the United States recently held, unequivocably, that the Federal Arbitration Act preempts State law, when the subject contract affects interstate commerce (*Southland Corp. v Keating*, 465 US 1, 104 S CT 852).

Although the United States Congress, by enacting the Federal Arbitration Act, has "declared a national policy favoring arbitration"* (*Southland Corp. v Keating, supra*, p ____, p 858), there are instances when Federal courts will stay arbitration of one part of a controversy while another part of the controversy, not subject to arbitration, is permitted to proceed first in a judicial forum. Some examples of Federal courts staying arbitration, while allowing the court action to move forward, are: (1) in cases involving, *inter alia*, antitrust issues, which on public policy grounds have been held inappropriate for resolution by arbitration,** upon the basis that the antitrust issues so permeate the controversy that the arbitrator can "not easily separate the antitrust issues from the other arbitrable issues and [can] not easily decide the arbitrable issues without inquiry into the antitrust issues" (*Applied Digital Technology v Continental Cas. Co.*, 576 F2d 116, 118); (2) in cases involving, *inter alia*, Federal securities law issues, which are nonarbitrable under Federal law,*** upon the basis "that when it is impractical if not impossible to separate out nonarbitrable federal securities law claims from arbitrable contract claims, a court should deny arbitration" (*Sibley v Tandy Corp.*, 543 F2d 540, 543, reh den 547 F2d 286, cert den 434 US 824), (3) in a case involving a property damage suit, where there was an arbitrable issue of the insurer's duty to defend, the arbitration of that issue was stayed while an issue of liability, which was not subject to arbitration, was allowed to go to trial, upon the basis that there was "the possibility of conflicting fact-finding" between the arbitrator and the court on the key issue of liability

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* New York State also has announced a policy that favors and encourages arbitration (*Matter of Nationwide Gen. Ins. Co. v Investors Ins. Co.*, 37 NY2d 91, 95).

** *American Safety Equip. Corp. v Maguire & Co.*, 391 F2d 821 (CA2d).

*** *Wilko v Swan*, 346 US 427.

(*Petroleum Helicopters v Boeing-Vertol Co.*, 478 F Supp 84, 87, affd 606 F2d 114); and, (4) in a case involving a breach of contract, where the nonarbitrable claims far outnumbered the arbitrable ones, upon the basis that "[u]nder all the circumstances, the interests of the parties would best be served by staying the arbitration" (*Bell Canada v ITT Telecommunications Corp.*, 563 F Supp 636, 641).

Applying the legal concepts contained in these Federal cases, cited *supra*, to the facts of the instant case, which involves an action brought by a corporation, whose stock is publicly held by thousands of shareholders, we conclude that the interests of justice require that arbitration be stayed and the consolidated actions be allowed to proceed to trial. We find the following factors significant in making our determination:

1. that the arbitrable issue of the employment agreement is only a minor part of the larger controversy involving nonarbitrable issues such as corporate waste, breach of fiduciary duties, mismanagement and issuing misleading information in the proxy contest;

2. that, if the arbitration is permitted to go forward, there is a strong danger that the arbitrators will be unable to separate the arbitrable issue of the employment agreement from the nonarbitrable issues and the result may be inconsistent fact finding between the arbitrators and the court on the nonarbitrable issues; and,

3. that the individual members of the old Board, who are defendants in the GAF consolidated action, are not parties to the arbitration and we are concerned that the arbitrators may make an award that may have collateral effect in the consolidated actions.

Werner argued that the court can only stay the arbitration if the ground for the stay is specifically set forth in CPLR 7503, otherwise, the court has no power to act. The courts have consistently held to the contrary. CPLR 2201 has been construed as permitting a stay to "avoid a multiplicity of suits, or * * * prevent litigation of an issue which should more appropriately be

litigated in the other action" (2A Weinstein-Korn-Miller, NY Civ Prac, par 2201.03, p 22-11). Further, the court has specifically exercised its inherent power to stay an arbitration pending the trial of a related lawsuit (*Matter of Sun Rubber Co. [New York Credit Men's Adj. Bur.]*, 278 App Div 933, affd 303 NY 961). Further, almost 50 years ago, Justice Cardozo wrote for a majority of the United States Supreme Court, in *Landis v North Amer. Co.* (299 US 248, 254-255): "[P]ower to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants. How this can best be done calls for the exercise of judgment, which must weigh competing interests and maintain an even balance". Our decision in the instant case meets this *Landis* test of maintaining an even balance, without prejudicing either party.

Accordingly, the order, Supreme Court, New York County (Martin Evans, J.), entered May 15, 1984, which, *inter alia*, (1) denied GAF's motion to stay arbitration, (2) granted Werner's cross motion to compel arbitration, (3) granted GAF's cross motion to consolidate the two court actions, and, (4) *sua sponte* stayed the trial of the consolidated actions insofar as the issues related to the employment agreement which the arbitration proceeding is to consider, should be modified, on the law, the facts and in the exercise of discretion, to the extent of (1) granting the petition to stay arbitration; (2) denying the cross motion to compel arbitration; (3) vacating the stay of the trial of those issues pertaining to the employment agreement, and otherwise affirmed, with costs.

KUPFERMAN, J. P., CARRO and FEIN, JJ., concur.

Order, Supreme Court, New York County, entered on May 15, 1984, unanimously modified, on the law, the facts and in the exercise of discretion, to the extent of (1) granting the petition to stay arbitration; (2) denying the cross motion to compel arbitration; (3) vacating the stay of the trial of those issues pertaining to the employment agreement, and otherwise affirmed. Appellant shall recover of respondent $50 costs and disbursements of this appeal.

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: SPECIAL TERM PART I

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Application of GAF Corporation,

Petitioner,

Index No. 2852/84

For an Order Pursuant to Article 75 of the CPLR Staying Arbitration of a Certain Controversy,

-against-

JESSE WERNER,

Respondent.

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MARTIN, EVANS, J.:

This is a motion to stay arbitration. On the respondent's cross motion to compel arbitration and to disqualify an arbitrator appointed by petitioner, petitioner seeks by its own cross motion to stay a certain action brought by respondent against petitioner to consolidate an action recently brought by petitioner against respondent with an action to recover the value of stock options [not an arbitrable question] by respondent against the corporation.

Succinctly, the petitioner is a large corporation which, as the result of a successful proxy fight, has had a change of management. Respondent is the former president of the corporation. After the change in management, certain rights to which respondent claimed to be entitled were withheld from him by action of the corporation. One of these was his claim to salary and other benefits under an employment agreement. Under the terms of that agreement, he served a demand for arbitration.

Respondent, under other agreements, which did not include arbitration clauses, claimed to be entitled to certain stock options, and having elected to exercise the options, has instituted

an action to recovery his damages arising from the refusal of the corporation to honor his execution of the options. He also seeks, under certain corporate resolutions, the recovery of his litigation expenses, and an award of damages, both compensatory and punitive, for what he terms the bad-faith actions of the corporation and its present directors.

The corporation, on the other hand, has instituted or is about to institute an action against respondent, based on various claims of mismanagement and breaches of fiduciary duty. This proposed action will be, in effect the consolidation of five stockholder derivative actions previously commenced by individual stockholders. These will probably be dismissed since the corporation, under its new management, has signified its desire to bring these causes of action itself.

These claims consist of matters that have taken place since 1980 and involve such diverse claims as improvident salary agreements, the dissemination of improper proxy information, and the payment of improper and excessive fees during the proxy battle.

The arbitration sought by respondent is to determine his right to salary for the period commencing in the last half of December, 1983, and certain other benefits provided for in the employment agreement.

Although the petition to stay arbitration is brought under CPLR 7503(b), calling into question the rules regarding arbitration set forth in Article 75, CPLR, the proceeding involves one of the large American corporations, whose state of incorporation is Delaware, and whose stock is actively traded on the stock exchanges. Clearly implicated is the Federal Arbitration Act. However, since the rules, and policies are entirely similar, there is no conflict between the Federal and State jurisdictions in this matter. If there were, and since this is a matter involving interstate commerce, the Federal rules would necessarily be required to be applied. *See Southland Corp. v. Keating*, 104 S.Ct. 852 (1984).

The employment agreement was made in 1981, apparently for a five year term. It contained, in Paragraph 12, the following provision for arbitration:

12. Arbitration

> "In the event that any disagreement of any kind shall arise between the parties hereto as to any matter or thing whatsoever hereunder, such disagreement shall be arbitrated in the City of New York in the following manner. . . ."

This is a broad form of arbitration agreement, and has been in each of respondent's employment agreements since 1965. These employment agreements, since the corporation went public in 1965, have been disclosed in annual proxy statements and in filings by the corporation with the Securities and Exchange Commission.

The arbitration panel was designed to consist of three arbitrators; one chosen by each of the parties, and the third to be a neutral arbitrator, chosen by the first two or if they are unable to agree, by the President of the Association of the Bar of the City of New York.

Although petitioner characterizes this method of choosing arbitrators as unusual, this tri-partite method of choosing arbitrators is widely used and has received judicial recognizance and approval. *Matter of Astoria Medical Group*, 11 N.Y.2d 128.

Recognizing that, even if there are valid corporate claims against respondent for breaches of fiduciary duties such as overreaching in the formation or fraud in the inducement of the employment contract which includes the arbitration clause, the question of the validity of the arbitration clause would be a matter for the arbitrator to decide. *Matter of Weinrott* (Carp) 32 N.Y.2d 190, 199; *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 87 S.Ct. 1801, 18 L.Ed.2d 1670 (1967), the petitioner rests its motion to stay arbitration on a doctrine which it called "permeation."

It is settled law, that cases involving violation of the Federal Securities Acts are as a matter of public policy, not arbitrable under a pre-existing arbitration agreement. *Wilko v. Swan* 346

US 427, 74 S.Ct. 182, 98 L.Ed. 168 (1953). From this has stemmed the doctrine, that where it is impossible to separate out non-arbitrable federal securities claims from other claims in one action, the court should deny arbitration in order to preserve its exclusive jurisdiction over those claims. *Shapiro v. Jaslow* 320 F. Supp. 598.

Neither are private claims arising under the anti-trust laws arbitrable. *American Safety Equipment Corp. v. J.P. Maguire & Co.* 391 F.2d 821 (1968).

As the court stated in Applied Digital Technology Inc v Continental Casualty Co., 576 F2d 116 (1978)

> "Permeation, as articulated by the courts that have addressed it, is a somewhat elusive concept. Most courts have found permeation if an arbitrator could not easily separate the antitrust issues from the other arbitrable issues and could not easily decide the arbitrable issues without inquiry into the antitrust issues. *Cobb v. Lewis* 488 F2d 41. On the other hand, there is a reluctance to hold that the antitrust issues permeate the entire case unless the antitrust charges appear to have a relatively good chance for success. . . ."

Analysis of the putative claims of petitioner is necessary to determine whether or not there are any claims which may affect the arbitrable claims of respondent for his compensation under his employment agreement in such a manner as to preclude arbitration. For this to occur, there must be a reasonable likelihood that there will be factual findings in arbitration which would preclude a contrary factual finding in a trial; and that the factual findings in a trial would be in a cause of action as to which, by the applicable rules of public policy, no arbitration might be had. With this in view, the five derivative actions, all of which the petitioner claims it will pursue in one new action, which it denoted the "consolidated" action, will be analyzed.

For it must be kept in mind, that even if there are similarities in facts, and even if there will be an overlapping of evidence or

the chance of contrary findings, public policy in favor of arbitration is sufficiently strong so that the arbitration may proceed, and the actions will be stayed, unless the actions are of the kind previously denoted as being contradictory of arbitration.

The five actions may be referred to by the names of the plaintiffs, as Stotland, Miller, Weinberger, Heyman and Heyman. (Heyman, who has brought the last two derivative actions, was the successful contender in the recent proxy battle for control of the management of the corporation.)

In Stotland, the essential claims were that the defendants caused the corporation to incur unnecessary overhead expenses, including excessive salaries and other employment benefits, far in excess of a reasonable wage. It also alleged that the defendants failed to liquidate the corporation when they should have done so. The Miller complaint alleges improper accounting for profits, which resulted in excessive payments to the Executive Incentive Compensation Fund. The Weinberger complaint alleges excessive compensation to respondent based on the operations of the corporation. The first Heyman complaint alleges that defendants caused the corporation to issue misleading material in connection with the proposed and actual proxy contests in which the plaintiff was engaged, in order to defeat plaintiff's attempts to gain control of the corporation. It sought an injunction against the issuance of such information, and damages for the expenses incurred in sending out the information. Except for the damage aspect, for the costs of sending out the information, that action appears to be moot. The second Heyman action alleges, as do some of the other stockholder actions, a wasteful employment contract allowing excessive compensation paid to respondent and various representations of respondents intended to cause plaintiff to refrain from a proxy contest and included charges of improper accounting practices which resulted in excessive payments to the Executive Incentive Compensation Plan. Plaintiff also alleged various misrepresentations made to the stockholders of the corporation to induce them to vote for the management of the corporation rather than for the persons proposed by plaintiff, in a proxy contest; and the complaint seeks, in addition to injunctive

relief which is now moot, the recovery of the costs to the corporation of the allegedly misleading information.

It is apparent, that, while there are some minimal claims under the Federal Securities Acts, which involve misleading proxy information, these claims do not particularly impact upon the common law claims of waste and improvident management.

In addition, the corporation has indicated its intent to have these claims dismissed so that it can pursue them itself. However, its proposed complaint, dated March 6, 1984, which may have been served by this date, makes no claims under the Federal Securities Acts, but merely alleges common law claims of waste and mismanagement, and improvident conduct on the part of the defendant. Federal Securities Act violations, if implied in the complaint by the corporation, may rise to the minimal standard but not above it. There is, therefore, no good reason why the arbitration should be stayed.

The doctrine of permeation should not be extended beyond the cases where either security law violations, private antitrust suits, or other actions as to which public policy requires that there be no arbitration. Otherwise, merely by bringing a common law action which involves the same issues as are before an arbitrator, a litigant could prevent or indefinitely delay arbitration. This, it has been held, would itself be contrary to the strong public policy in favor of arbitration. *Harris v. Shearson Hayden*, 82 AD2d 87 (1981).

To the extent that there may be some issues of fact common to both the arbitration and the common law claims of waste, the long settled policy of the courts is to allow the arbitration to proceed. *Sibley v. Tandy Corp.* 543 F2d 540. As was stated in *Sibley*, "the securities law claim was the rather small tail to a much larger dog."

Here, the large dogs are the issues of the claimed overpayments, and the improvident contract of employment, and the right of respondent to recover the salary and emoluments due him by contract. The small tail is the allegation of misleading information,

alleged to have been issued for the purpose of a proxy fight, and the expense to the corporation of that.

If the proxy contest statements were misleading, and if the defendant should be cast in damages for that, in a litigation in court, a consequent judgment for damages may be issued. That would have no relation to the issues raised in the arbitration, to the validity of the 1981 employment contract, and the payments due under the employment contract. Of course, the court cannot and should not pass on the question of the misleading effect of the proxy statements. But, if it were necessary to assess the likelihood of success of the plaintiffs on that issue, *Applied Digital Technology Inc. v. Continental, supra*, it cannot be said on these papers that plaintiff has shown any great likelihood of success. Puffery and questions of interpretation of statements may abound; that there was deliberate misinformation has not been shown except in a conclusory fashion. *See, Todd v. Oppenheimer & Co., Inc.* 78 F.R.D. 415 (1978).

Respondent's motion to disqualify the arbitrator named by petitioner is denied. In this tri-partite arbitration, it is to be expected that the arbitrator named by each of the parties will be partial toward that party. It cannot be said in advance of the arbitration that the arbitrator so chosen will violate his oath. In the event that his award is displeasing, it may be attacked, after the award, but solely on the grounds set forth in the CPLR 7511. *Matter of Astoria Medical Group*, 11 NY2d 128.

Petitioner's motion, to consolidate what it terms Action No. 1 with Action No. 3, is granted. The parties are the same; and some of the evidence may be overlapping. No sound reason has been shown why this should not be done. Both actions have been recently commenced, and no discernible prejudice is shown to either party by the consolidation.

It is apparent that many of the issues in arbitration, and in the consolidated action, are the same. Probably the central issue, in both, is that of the propriety, or impropriety of the employment agreement entered into between the corporation and its former president.

Since the parties have, prima facie, chosen arbitration, as the forum in which all matters concerning the employment agreement are to be determined, it would be in accordance with the intent of the parties, and would be a proper exercise of the discretion of the Court, to stay the consolidated action, to the extent that the issues are the same as those in arbitration, from proceeding until the arbitration process has been completed. Otherwise, their intent would be frustrated by a determination in a forum not of their contractual choosing.

Settle order in accordance with the foregoing.

Dated: 4/3/84

Martin Evans, J.S.C.

At a Special Term, Part I, of the Supreme Court of the State of New York, held in and for the County of New York, at the County Courthouse, New York, New York, on the 27th day of April, 1984.

PRESENT:

HON. MARTIN EVANS, Justice

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GAF Corporation,

Plaintiff,

- against -

Jesse Werner, T. Roland Berner, Peter Bosshard, Augustine R. Marusi, Herman Sokol, Nolan B. Sommer and Robert Spitzer,

Defendants.

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(Action No. 1)
Index No. 5683/84

Application of GAF Corporation,

Petitioner,

For an Order Pursuant to Article 75 of the CPLR Staying Arbitration of a Certain Controversy

- against -

Jesse Werner,

Respondent.

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(Proceeding No. 2)
Index No. 2852/84
ORDER

Jesse Werner,

Plaintiff,

- against -

GAF Corporation, Samuel J. Heyman, Daniel T. Carroll, Robert C. Wilson, Sanford Kaplan, Jacob E. Goldman, William P. Lyons, Scott A. Rogers, Jr., Edward E. Shea, William Spier, Joseph E. Tydings, Robert H. Beber and Richard F. Smith,

Defendants.

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(Action No. 3)
Index No. 3926/84

GAF Corporation ("GAF") having petitioned this Court in Proceeding No. 2 for an order, pursuant to CPLR §7503(b), staying the arbitration demanded by respondent, Jesse Werner ("Werner"), pending the disposition of Action No. 1; and

Werner having cross-moved for an order, pursuant to CPLR §§ 7503(a), 7504, and 7506(a), compelling arbitration and disqualifying GAF's party-appointed arbitrator and, subsequent to the service of GAF's petition, having commenced Action No. 3; and

GAF, having cross-moved, pursuant to CPLR §2201 or, alternatively, §602(a), after the commencement by Werner of Action No. 3 for an order that Action No. 3 be stayed or, alternatively, consolidated for trial with Action No. 1;

Now, upon reading GAF's Notice of Petition and Verified Petition to Stay Arbitration dated February 3, 1984 and the exhibits thereto, and GAF's Notice of Cross-Motion dated March 8, 1984, the annexed affidavit of Norman Solovay, Esq., dated March 8, 1984, and the exhibits thereto, all in support of GAF's Petition and Cross-Motion and in opposition to Werner's Cross-Motion; and upon reading Werner's Notice of Cross-Motion to Dismiss Petition, Compel Arbitration and Disqualify GAF's Party-Appointed Arbitrator, dated March 1, 1984, the annexed affidavits of Jesse Werner, dated March 1, 1984 and of Samuel N. Greenspoon, Esq., dated February 27, 1984, and the exhibits thereto, and the Reply Affidavit of Arthur Richenthal, Esq., dated March 10, 1984, all in opposition to GAF's Petition and Cross-Motion and in support of Werner's Cross-Motion; and upon reading all other papers filed herein;

Now, upon filing the opinion of the Court, and on motion of Holtzmann, Wise & Shepard, attorneys for GAF, it is ordered that:

1. The motion of Petitioner GAF Corporation, to stay arbitration is denied and the cross-motion of respondent, Jesse Werner, to compel arbitration of those issues arising under and pursuant to a purported agreement between GAF and Werner dated September 17, 1981 is granted;

2. The cross-motion of Jesse Werner to disqualify the arbitrator appointed by GAF Corporation is denied and, subject to any stay which may be issued by this Court or the Appellate Division, pending appeal, the 10-day period provided by paragraph 12 of the purported September 17, 1981 agreement for the two party-appointed arbitrators to seek to agree upon a third neutral arbitrator shall commence to run 20 days after service of notice of entry of this order;

3. The cross-motion of GAF Corporation is granted to the extent of consolidating Action No. 1 and Action No. 3 into one action (the "Consolidated Action"), each party is granted leave to serve a further responsive pleading therein, including counterclaims, if any, within 20 days after service of notice of entry of this order, and the respective pleadings in these actions will thereafter stand as the pleadings in the Consolidated Action;

4. The costs of the actions hereby consolidated up to the date of this order and of Proceeding No. 2 shall abide the event of the Consolidated Action and the successful party or parties may tax with their costs such costs as have previously accrued to them.

5. Subject to the further order of this Court following application made on notice to all parties, the trial of the Consolidated Action is stayed as between GAF Corporation and Jesse Werner as to those specific issues relating to the compensation rights, if any, under the purported agreement of September 17, 1981, which are properly before the Arbitrators for decision without prejudice, however, to the conduct therein of pre-trial discovery and all other appropriate pre-trial proceedings.

Enter.

Dated: New York, New York
April 27, 1984

_____

J.S.C.
New York County

APPENDIX B

Sections 2-4 Of The Federal Arbitration Act, 9 U.S.C. §§2-4

§2. *Validity, irrevocability, and enforcement of agreements to arbitrate*

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

July 30, 1947, c. 392, 61 Stat. 670.

§3. *Stay of proceedings where issue therein referable to arbitration*

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

July 30, 1947, c. 392, 61 Stat. 670.

§4. *Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination*

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save

for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial or such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

July 30, 1947, c. 392, 612 Stat. 671; Sept. 3, 1954, c. 1263, § 19, 68 Stat. 1233.

APPENDIX C

LISTING PURSUANT TO RULE 28.1 OF THIS COURT

GAF CORPORATION

LIST OF GAF AFFILIATES

Domestic Affiliates

Bloomfield Investments, Inc.
Bootes Investments, Inc.
Colville Investments, Inc.
Cresthill Investments, Inc.
East Point Investments, Inc.
Elmhurst Investments, Inc.
GAF Broadcasting Company, Inc.
GAF Chemicals Corporation
GAF Export Corporation
GAF Hawaii, Inc.
GAF International Corporation
GAF Realty Corporation
General Aniline & Film Corporation
Greenwich Transfer, Inc.
Highland Investments, Inc.
Jay & Company, Inc.
Lakewood Investments, Inc.
Linton Investments, Inc.
Mayfair Investments, Inc.
Mystic Investments, Inc.
Plymouth Investments, Inc.
Ramsey Investments, Inc.
Rockport Investments, Inc.
Roseworth Investments, Inc.
Soho Investments, Inc.
Taurus, Inc.
Washburn Investments, Inc.

Foreign Active Affiliates

GAF (Australasia) Pty. Ltd.
GAF (Belgium) N.V.
GAF do Brasil Industria e Comercio Ltda.
GAF (Canada) Inc.
GAF (Deutschland) G.m.b.H.
GAF (France) S.A.
GAF (St. Thomas) Foreign Sales Corporation
GAF (Great Britain) Co. Ltd.
GAF Huls Chemie G.m.b.H.
GAF Insurance Ltd.
GAF (Italia) Ltd.
GAF (Japan) Ltd.
GAF Corporation de Mexico, S.A. de C.V.
GAF (Norden) A.B. (formerly GAF (Svenska))
GAF (Osterreich) G.m.b.H
GAF (Singapore) Private Ltd.
GAF (South Africa) Pty. Ltd.
GAF (Switzerland) A.G.

Foreign Dormant Affiliates

GAF (Ireland) Ltd.
GAF Mullingar Ltd.
Sawyer's Japan Ltd.
Sawyer's (Nederland) N.V.
Sawyer's Photographic Products (U.K.) Ltd.